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U S WEST, Inc.
Suite 700
1020 Nineteenth Street, NW
Washington, DC 20036
202 429-3106
FAX 202 296-5157

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Cyndie Eby
Executive Director-
Federal Regulatory

July 9, 1996

RECEIVED

JUL 9 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

EX PARTE PRESENTATION

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

RE: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996
CC Docket No. 96-98

Dear Mr. Caton:

On July 9, 1996, U S WEST, Inc. ("U S WEST") held a meeting at the Federal Communications Commission concerning the above-referenced proceeding. The meeting was with Les Selzer, Senior Economic Advisor - Competitive Pricing Division of the Common Carrier Bureau; Mr. Patrick J. DeGraba, Industry Economist - Policy and Program Planning Division of the Common Carrier Bureau; C. Anthony Bush, Economist - Competitive Pricing Division of the Common Carrier Bureau; Brad Wimmer - Competitive Pricing Division of the Common Carrier Bureau; and Bill Sharkey, Senior Economist - Policy and Program Planning Division of the Common Carrier Bureau.

In attendance at the meeting on behalf of U S WEST were Robert Harris, Principal of the Law & Economics Consulting Group, Inc.; Dennis Yao, Associate Professor at The Wharton School (University of Pennsylvania); Cyndie Eby, Executive Director - Federal Regulatory; and Bill Johnston, Executive Director - Markets and Interconnection Advocacy. U S WEST expressed the following points: 1) the FCC should issue broad pricing guidelines based on full economic cost recovery; 2) the FCC should exercise leadership by moving quickly to reform access charges to prevent arbitrage; and 3) the FCC should urge

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states to rebalance rates. The attached outline was used in the oral presentation. Pursuant to paragraph 291 of the NPRM released in the above-referenced proceeding on April 19, 1996, this material does not count against U S WEST's page limit for ex parte filings made in this proceeding.

In accordance with Commission Rule 1.1206(a)(1), two copies of the document left with the FCC staff accompany this notice of presentation and are being filed with you for inclusion in the public record. Acknowledgment and date of receipt of this letter are requested. A copy of this transmittal letter is provided for this purpose. Please contact me if you have any questions.

Sincerely,

Cyndie Eby

Attachment

cc: Patrick J. DeGraba
C. Anthony Bush
Les Selzer
Bill Sharkey
Brad Wimmer

Ex Parte Presentation
Economic Analysis of
Robert G. Harris & Dennis A. Yao

US WEST INC.*

FCC Docket CC 96-98

July 8, 1996

*Includes U S WEST Communications
& U S WEST Media Group

LECG

Overview

- Prices for local service, call termination, and unbundled elements should be based on and marked up from TSLRIC
- Prices should reflect the fact that the costs of telecommunications services vary widely across population density
- Below-cost wholesale rates will promote resale and marketing-driven entry over facilities-based and technology-drive competition
- Basic exchange rates should be rebalanced

Incumbent LECs Face Asymmetric State Regulatory Requirements

- Geographic price averaging rules
- Additional limitations on pricing flexibility
- Carrier-of-last-resort obligations
- Ready-to-serve and quality-of-service standards

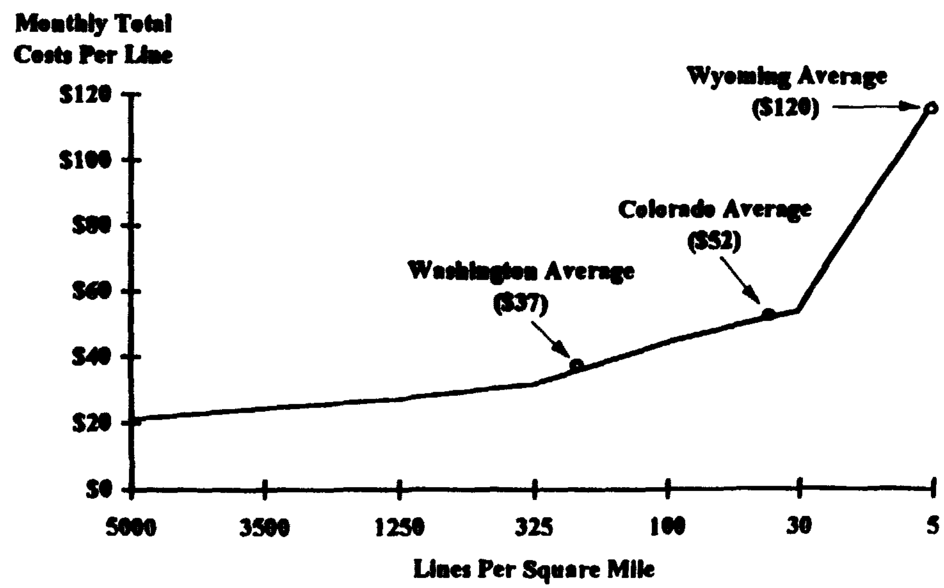
Prices Of Local Exchange Service Must Be Based On Cost

- Prices which are not based on cost are not sustainable in a competitive environment
- States must be required to price local service based on cost
- If local service is priced below cost, new entrants and high margin customers will arbitrage rate structure and incumbent LECs will be left with unprofitable customers

Avoid "One Size Fits All" National Pricing Policies

- Costs of local service, network elements, and call termination vary markedly with population density
- Federal pricing guidelines must allow cost differences

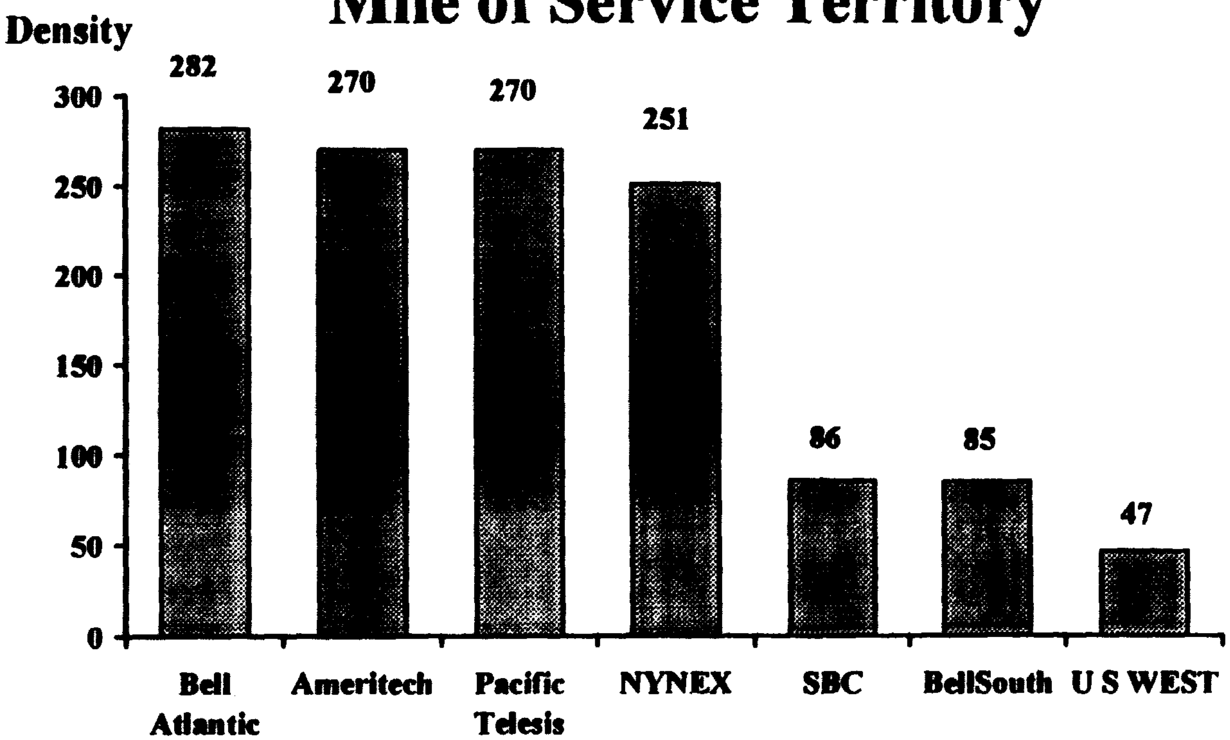
Local Exchange Costs Across Line Density



Sources: U S WEST; Independent work derived from INETEC (Proxy Cost Model developed for Pacific Bell)

U S WEST Has The Highest Avg Cost Structure Of Any RBOC

Access Lines Per Square Mile of Service Territory

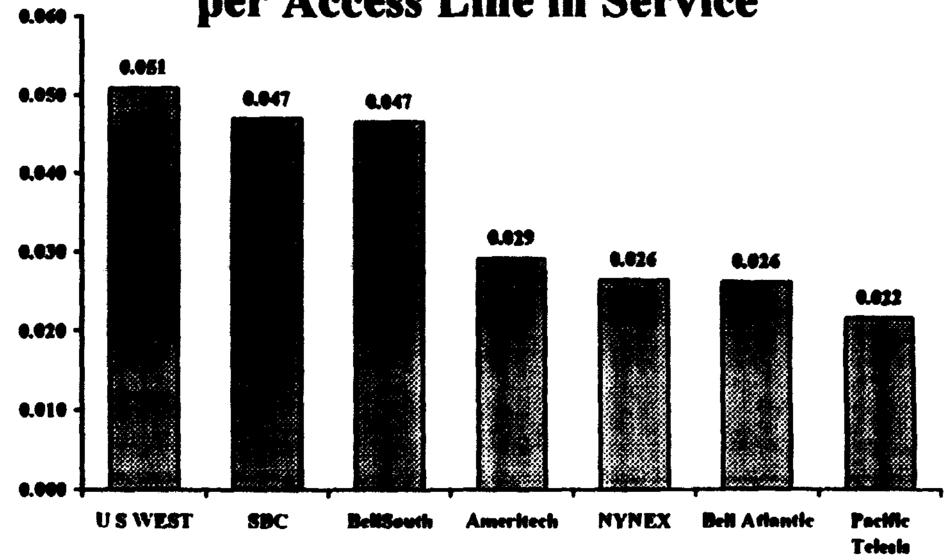


Source: U S WEST

Access Line Lengths And Costs Vary Markedly Across LECs

- U S WEST has the longest average loop lengths among RBOCs
- Bundled service and unbundled network element prices must reflect cost differences due to geographic factors such as population density

Sheath Kilometer of Transmission Facilities per Access Line in Service

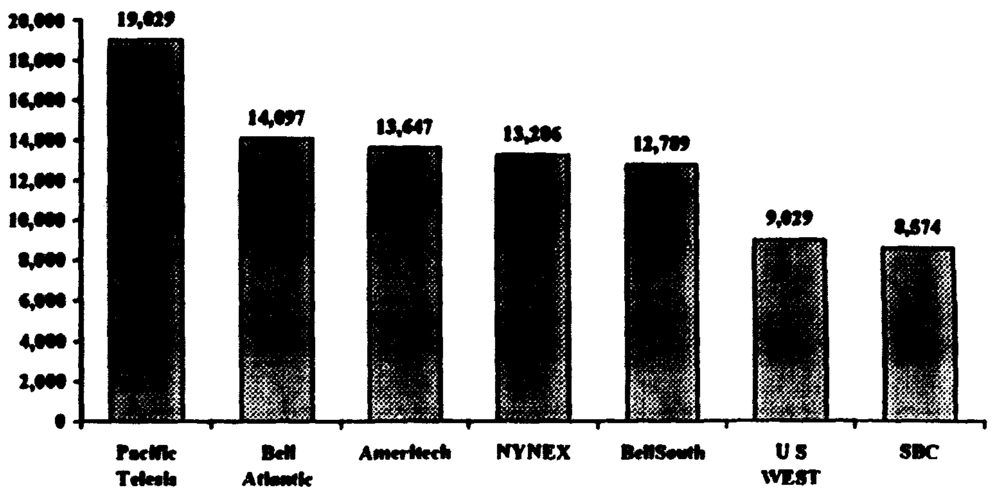


Sources: 1995 ARMIS 43-07 Reports

Local Office Switching Costs Also Vary Across LECs Due To Differences In Density

- U S WEST has the second lowest number of lines per Local Switch
- U S WEST operates more switches to serve its customers and thus has higher switching costs

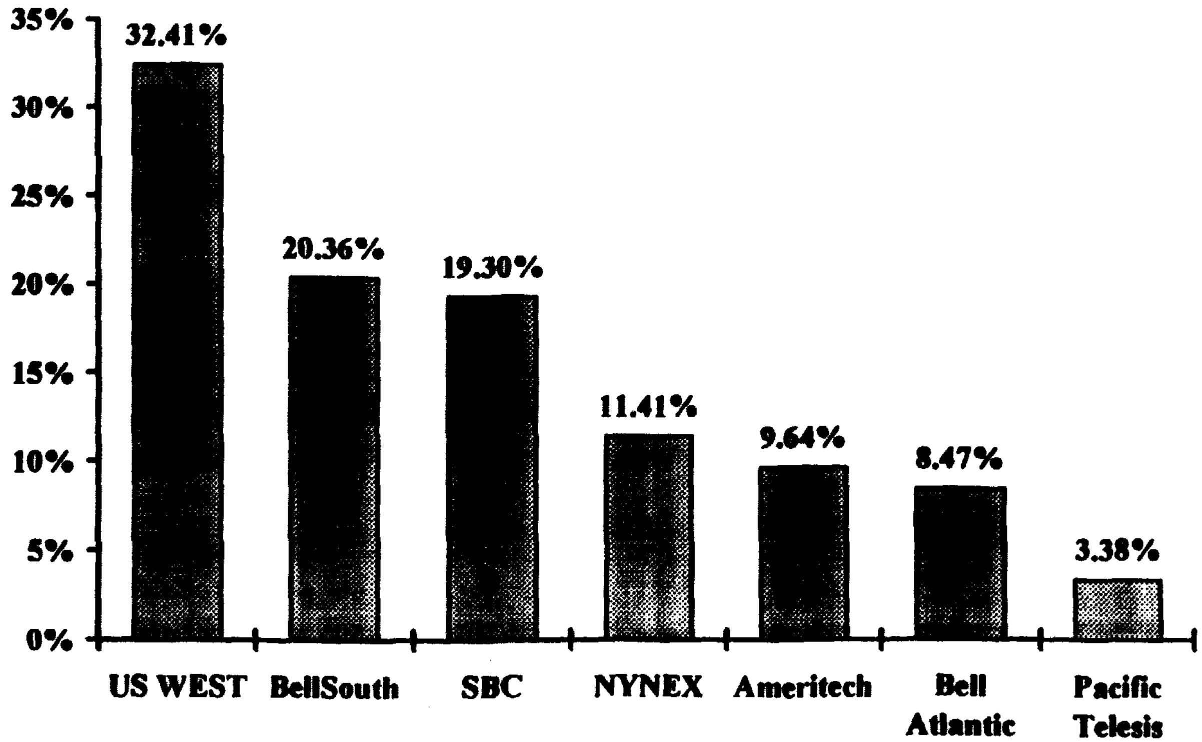
Access Line in Service per Local Switch



Sources: U S WEST

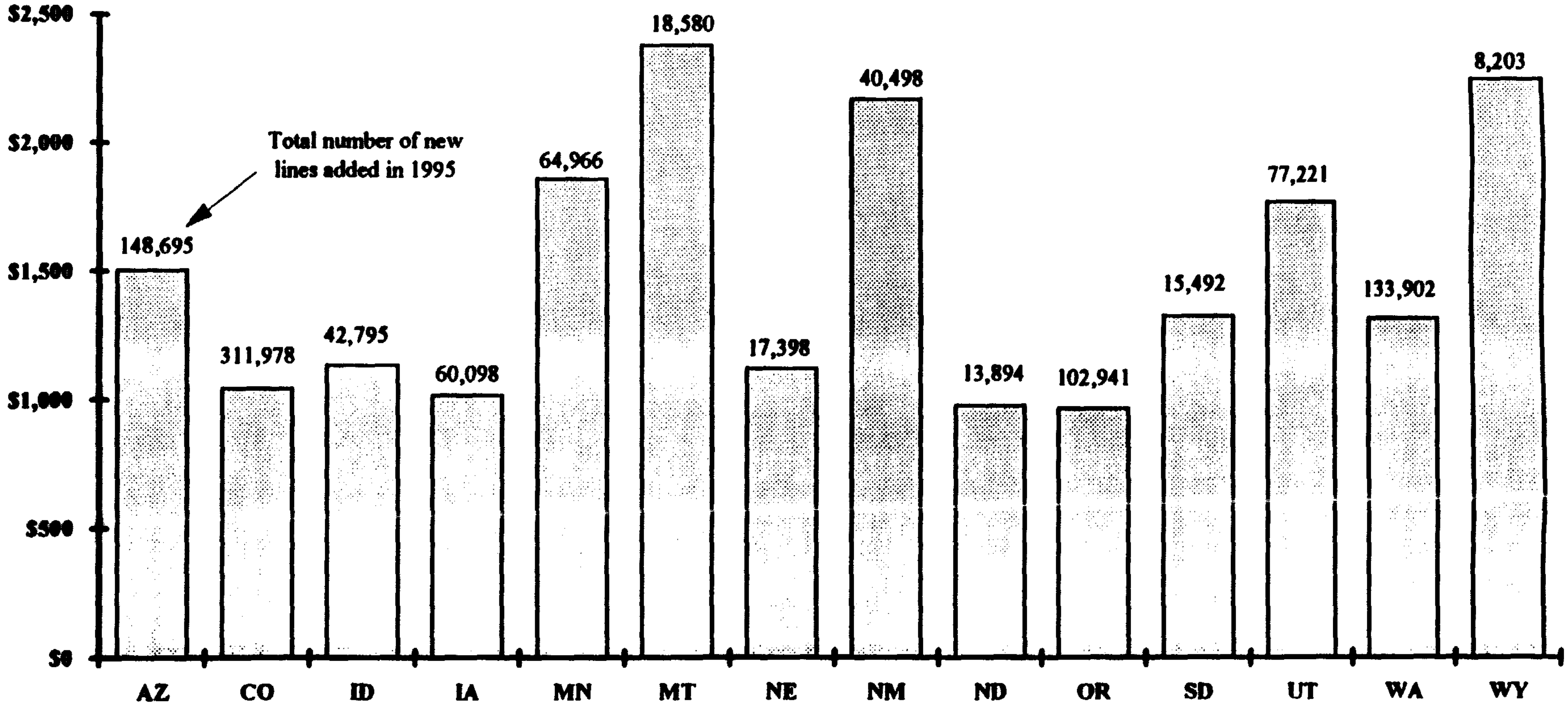
U S WEST Has The Highest Cost Structure Of Any RBOC

Percentage of Rural to Urban Access Lines



Source: U S WEST

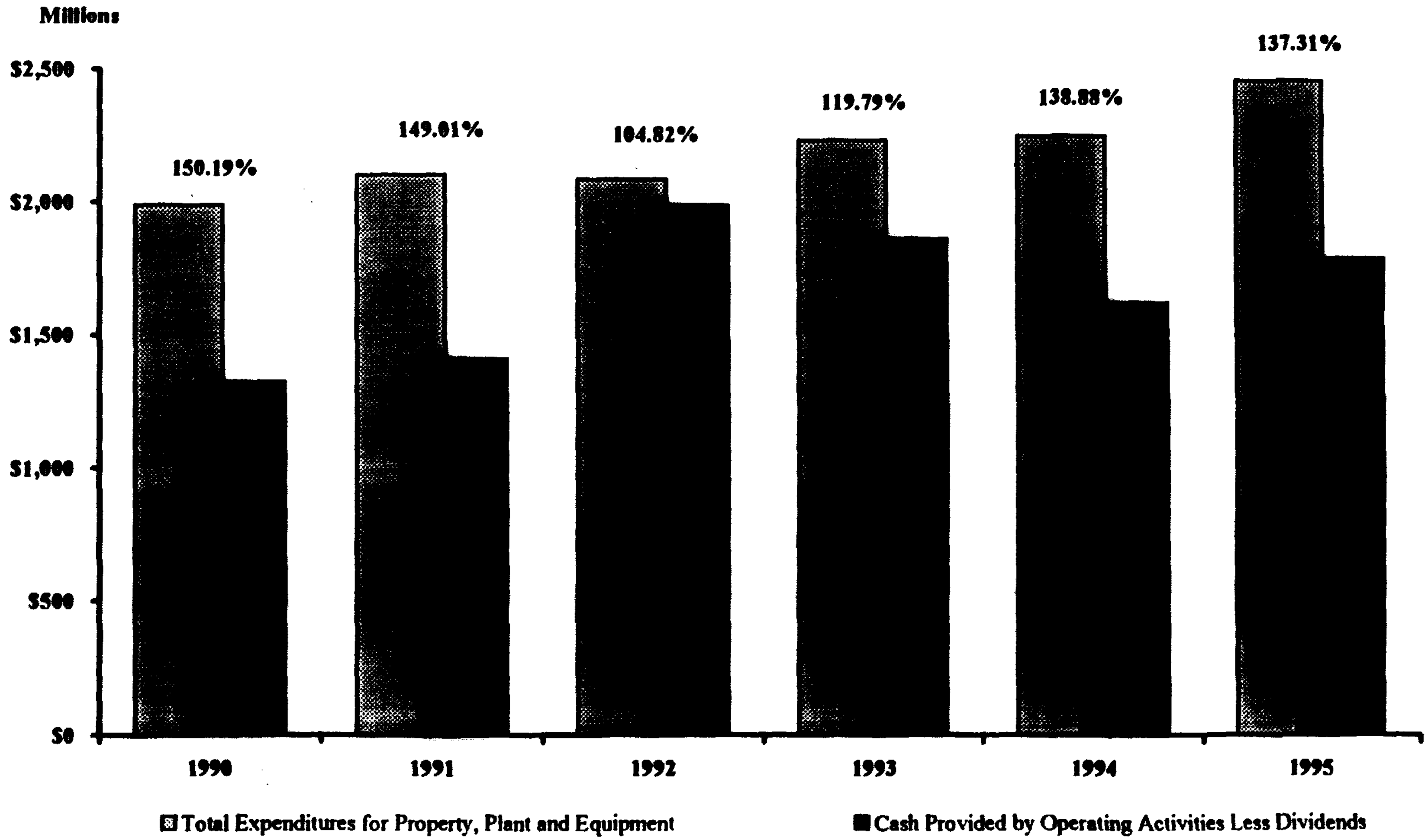
U S WEST Communications' Capital Constuction Expenditures Per Line Added and Total Lines Added in 1995 by States



* An "additional line" is defined as a newly constructed local loop connected to the main distribution frame, also known as "assessable capacity."
* Capital Construction expenditures are defined as expenditures on equipment with a life span greater than 1 year such as switches, conduits, and transmission cables.

Sources: U S WEST Internal Reports

U S WEST Communications' Investment in P.P.E. as a Percent of Gross Operating Cash Less Dividends



Sources: U S WEST

There Are Substantial Costs And Cash Flow Implications Of Telecom Act Implementation

- Requiring requesters to pay the cost of unbundling promotes efficiency
- Interconnection terms are too complicated for regulatory fiat
- Carriers should negotiate contract terms

Provision	NPV Cost of Implementation 1996-2001 ($Millions)*
E/O Interconnection	$421
Unbundling Loop	$203
Number Port. (80% of Cos)	$808
Resale	$117
IntraLATA Dialing Parity	$31
Other Systems Costs	$331
Total	$1,911

*Costs include capital investments and operating expenses. Cost of capital for NP calculation was 10%. Source of estimated costs: U S WEST

Embedded Costs Are Larger Than TSLRIC Partially Due To Uneconomic Depreciation Rates

- U S WEST's regulated depreciation rates are lower than economic depreciation rates
- Depreciation rates should be set by market and technological factors, not regulators
- Artificially low depreciation rates resulted in uneconomically high embedded costs
- LECs should recover these embedded costs during transition to competition

Comparison Of TSLRIC To Embedded Cost Of Local Loop

Cost Type	Monthly Cost of Unbundled Local Loop in Colorado
TSLRIC	$19.48
TSLRIC + Mark Up for Shared Costs	$21.45
TSLRIC + Mark Up for Shared and Common Costs	$25.92
Embedded Costs	$32.35

Source: U S WEST Communications. Embedded Costs EOY 1995, TSLRIC Costs at 6/28/96. The same loop and central office elements are included in all cost types.

LECs Should Not Be Required To Write Off Investments

- Investments made under carrier-of-last-resort or ready-to-serve obligations should not be written off
- LECs' stranded plants are fundamentally different from companies (IBM, GM, Coca-Cola) in unregulated markets
- Embedded investment is prudently incurred and approved/mandated by regulators

Basic Exchange Rates Must Be Rebalanced

- Current business to residential subsidies are not sustainable; entrants will target business customers
- Unbundling and resale will dramatically increase the inefficiencies associated with unbalanced rates
- FCC should require states to rebalance rates based on costs (1FR, 1FB, IntraLATA Toll)

U S WEST Business And Residential Local Rates

	1 FR*	1 FB*
Arizona	$13.45	$17.65
Colorado	$15.66	$37.24
Idaho	$12.27	$33.62
Iowa	$12.16	$30.33
Minnosota	$15.50	$42.53
Montana	$14.47	$38.43
Nebraska	$15.78	$38.70
New Mexico	$15.62	$29.46
North Dakota	$13.02	$31.76
Oregon	$15.14	$30.86
South Dakota	$16.95	$30.92
Utah	$11.30	$18.51
Washington	$10.50	$26.03
Wyoming	$17.85	$30.26

*Does not include EUCL and Life Line charges.

Sources: U S WEST

Call Termination, Transport, And Network Elements Must Be Priced At Full Economic Cost

- Economic costs include: TSLRIC + markup for shared and common costs
- Without markups competitors will face lower costs than LECs using LECs network
- Without markups LECs retail customers will pay for competitors use of LECs networks

Pricing Wholesale Service Below Cost Is Inefficient

- Harms facilities-based service providers financially: LECs, CAPs, wireless companies
- Deters facilities-based entry
- Distorts the "make or buy" decision, reducing infrastructure investment
- Analogous to predatory pricing
- Favors IXCs by heightening importance of marketing and brand-name

IXCs Have Substantial Competitive Advantages and Do Not Need Preferential Policies

- Large customer bases and information about intensive Interexchange users
- Brand name recognition and reputation (10% of customers think AT&T currently provides their local telephone service, Chilton, 3/13/96 Press Release)
- Ability to provide one-stop-shopping or bundled service immediately
- Existing facilities and technical expertise
- Financial strength (AT&T 1995 Net Operating Cash flow $9.7 billion., Source: 10-K)

Advertising Expenditures of Selected Telecom Companies

(by 1995 Rank)

National Brand Rank			Spending ($ Mil.)	
1994	1995	Company	1994	1995
1	1	AT&T	698	673
8	9	MCI	325	321
24	24	Sprint	188	213
115	107	Ameritech	62	71
130	120	NYNEX	58	66
163	145	Bell Atlantic	47	59
133	155	U S West	57	57

Source: Craig Endicott, "Top 200 mega-brands by 1995 ad spending," Advertising Age, May 6, 1996, p. 34.

Preferential Policies Could Exacerbate IXCs Existing Competitive Advantages

- IXCs' entry into local exchange is product line extension not *de novo* entry
- Below cost wholesale artificially favors resellers over facilities-based providers
- IXCs are superbly positioned to leverage below cost resale prices into long-term competitive advantage
- Permanent market structure often depends on the "path" that technology or business competition follows

A Likely Result: Marketing Competition Dominates Technological Competition

- IXCs' superior brand name equity plus artificially low prices gives them first mover advantages over other entrants
- IXCs win in market share competition
- IXCs pursue a strategy to increase product differentiation and switching costs
- Smaller, non-integrated facilities-based firms fare poorly in the initial stages of market share competition and can't expand in a market characterized by product differentiation